

SENATE BILL REPORT

SB 5109

As Reported by Senate Committee On:
Trade & Economic Development, February 19, 2013

Title: An act relating to creating a business and occupation tax exemption for new businesses.

Brief Description: Creating a business and occupation tax exemption for new businesses.

Sponsors: Senators Padden, Benton, Smith and Conway.

Brief History:

Committee Activity: Trade & Economic Development: 2/05/13, 2/19/13 [DPS-WM].

SENATE COMMITTEE ON TRADE & ECONOMIC DEVELOPMENT

Majority Report: That Substitute Senate Bill No. 5109 be substituted therefor, and the substitute bill do pass and be referred to Committee on Ways & Means.

Signed by Senators Braun, Chair; Smith, Vice Chair; Baumgartner, Chase, Ranking Member; Holmquist Newbry, Schlicher and Shin.

Staff: Edward Redmond (786-7471)

Background: Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state. Revenues are deposited in the state general fund. There are several rate categories, and a business may be subject to more than one B&O tax rate, depending on the types of activities conducted. The B&O tax does not permit deductions for the costs of doing business, such as payments for raw materials and wages of employees. However, there are many exemptions for specific types of business activities and certain deductions and credits permitted under the B&O tax statutes.

Unlike deductions, where an activity must first be reported on a business' Combined Excise Tax Return (CETR) as part of its gross income and then deducted, an exempt activity is not subject to the B&O tax and is not reported on the CETR. Exempt activities include wholesale sales of agricultural products by farmers; qualified fundraising activities by qualified nonprofit organizations; state and federally chartered credit unions; and the sale or rental of real estate other than lodging.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Summary of Bill (Recommended Substitute): A credit against the B&O tax is created for new businesses. A new business may claim the credit against B&O taxes due for the first 12 months of operation unless the business has fewer than 25 employment positions. A new business with less than 25 employment positions may claim the credit against B&O taxes due for the first 24 months of operations and then is subject to 50 percent of the B&O tax due in the following 12 months.

A new business is defined as a business that has not been operating in Washington longer than 12 months from the time the business applies for the credit. The date is calculated from the time a new business first engages in any activity that generates gross income from sources within the state regardless of the business' physical presence. A new business does not include the following:

- a business that has been restructured or reorganized unless the new activities of the business are significantly different from its previous functions;
- a new branch location or facility unless it is from an existing out-of-state entity doing business in Washington for the first time; or
- a business that is substantially similar to a business currently operated, or operated within the past five years when the majority of the beneficial ownership is the same.

To qualify for the credit, a new business must file an application as required by the Department of Revenue (DOR).

EFFECT OF CHANGES MADE BY TRADE & ECONOMIC DEVELOPMENT COMMITTEE (Recommended Substitute):

- Changes tax exemption to tax credit.
- Provides a technical correction so that the tax credit is authorized during the first 12 months after being approved by DOR.
- Amends definition of new business to resolve the economic nexus issue. New business means a business that has not been operating in Washington longer than 12 months from the time the business applies for the credit. The date is calculated from the time a new business first engages in any activity that generates gross income from sources within the state regardless of the business' physical presence.
- Provides that a new business does not include a business that is substantially similar to a business currently operated, or operated within the past five years when the majority of the beneficial ownership is the same.
- Defines a business as substantially similar if it is within the same industry group of the North American Industry Classification System codes.
- Clarifies that the credit is only available to businesses that have registered with DOR in accordance to statute.

Appropriation: None.

Fiscal Note: Available.

Committee/Commission/Task Force Created: No.

Effective Date: The bill takes effect on July 1, 2013.

Staff Summary of Public Testimony on Original Bill: PRO: In my district businesses have relocated to the state of Idaho because the overall business climate there has been more favorable. We need new tools in our tool box to attract and retain businesses in Washington State. In 2009, DOR estimated as many as 90,000 businesses would benefit from this proposal over the course of four years. By lowering taxes over the first two years, this legislation addresses the issues raised by the Gates Foundation that new businesses have a higher tax burden than established firms and that the B&O tax creates a competitive disadvantage to new businesses compared to the tax policies of other states.

Washington State is the only state that imposes a B&O tax. A B&O tax taxes the gross revenue with no regard for the profitability of a company. Today there are small business employers that are trying to provide needed jobs. Maybe in a couple more years they will be able to provide three or four more jobs. Washington has the highest number of patents per capita of any state in the U.S. There are innovative people in this state that are eager to start businesses. We also have the most new business starts in the U.S. The problem is that we also have the highest number of new business failures in the country. Part of that is due to the fact that we are taxing away the money that these employers can reinvest into their companies and create new jobs.

OTHER: The Washington Policy Center holds annual forums dedicated to small businesses. Every year small businesses attend these forums and the number one recommendation to reform our small business climate is to reform the B&O tax. That recommendation is to benefit all employers not just new businesses; however, new business startups are clearly in need of some help. In 2010, Washington had the ninth highest business startup rate in the nation and the eleventh highest failure rate. In 2006, we had the third highest startup rate and the second highest failure rate; there is obviously a trend. Washington's B&O taxes are one of the factors contributing to this high failure rate.

Persons Testifying: PRO: Senator Padden, prime sponsor; Ron Newbry, Phoenix Associates Public Affairs.

OTHER: Erin Shannon, WA Policy Center.